

April 27, 2020

*State Taxes Only – See Separate
Analysis for Property Tax Impacts*

	Yes	No
DOR Administrative Costs/Savings	X	

Department of Revenue
Analysis of S.F. 3843 (Chamberlain), As Proposed to be Amended (SCS3843A-5)

	Fund Impact			
	<u>F.Y. 2020</u>	<u>F.Y. 2021</u>	<u>F.Y. 2022</u>	<u>F.Y. 2023</u>
	(000's)			
Angel Investment Credit (1/1/19)	\$0	(\$10,000)	\$0	(\$10,000)
Section 179 Expensing (1/1/18)				
Individual Income Tax	\$0	(\$172,600)	(\$27,500)	(\$15,200)
Corporate Franchise Tax	\$0	(\$65,500)	(\$10,500)	(\$5,900)
Charitable Subtraction for Non-itemizers (1/1/20)	\$0	(\$26,900)	(\$27,500)	(\$28,100)
K-12 Education Credit (1/1/20)				
Increased K-12 Credit	\$0	(\$13,900)	(\$14,200)	(\$14,500)
Reduced K-12 Subtraction	\$0	\$1,000	\$1,000	\$1,100
Lawful Gambling Tax (7/1/20)				
Combined Net Receipts Tax	\$0	(\$10,200)	(\$11,100)	(\$12,000)
Delay Estimated Tax Payments				
Individual Income Tax (TY20)	(\$430,000)	\$430,000	\$0	\$0
Corporate Franchise Tax (TY19 & 20)	(\$211,000)	\$211,000	\$0	\$0
Extension for Filing and Payment (TY19)				
Corporate Franchise Tax	(\$80,000)	\$80,000	\$0	\$0
Suspend June Accelerated Payments (6/1/20)				
General Sales Tax	<u>(\$293,500)</u>	<u>\$293,500</u>	<u>\$0</u>	<u>\$0</u>
General Fund Total	(\$1,014,500)	\$716,400	(\$89,800)	(\$84,600)
Natural Resources and Arts Fund Total	(\$17,000)	\$17,000	\$0	\$0
Total—All Funds	(\$1,031,500)	\$733,400	(\$89,800)	(\$84,600)

EXPLANATION OF THE BILL

Article 2: Individual Income, Business and Miscellaneous Taxes

Angel Investment Credit (*sections 1 and 15*)

The angel investment tax credit is the commonly-used name for the small business investment tax credit. The refundable individual income tax credit is equal to 25% of the investment made in a qualified small business. The maximum credit for a tax year is \$250,000 for a married couple filing a joint return and \$125,000 for other filers. The investment can be made directly by a qualified taxpayer or through a qualified angel investment network fund that invests in a qualified small business. The law specifies the requirements for the investor, the investment fund, the investment, and the small business.

Under current law, \$10 million in credits may be allocated in tax years 2019 and 2021. The credit expires at the end of tax year 2021. Effective the day following final enactment, the bill permanently extends the credit at a maximum of \$10 million per year beginning in tax year 2020.

Section 179 Expensing (*sections 2, 4 and 11*)

Section 179 of the Internal Revenue Code allows a taxpayer to treat the cost of qualified business property as an expense in the year the property is placed in service. The current limit on Section 179 expensing is \$1.0 million. That amount is reduced by one dollar for every dollar of property placed in service over \$2.5 million, so a taxpayer who places \$3.5 million or more of property in service during the tax year is ineligible. The thresholds are indexed for inflation beginning in tax year 2019.

For Minnesota purposes, a taxpayer must add back 80% of the difference between the amount deducted federally and the amount that was allowed under pre-2003 federal law (up to \$25,000, reduced by one dollar for each dollar that total expenses exceed \$200,000). The amount of the addback may be subtracted in equal parts over the next five years.

Effective retroactive to tax year 2018, the bill fully conforms to the increased limits on Section 179 expensing, eliminating the need for the addbacks and associated subtractions. Subtractions would continue to be claimed for additions made before tax year 2018.

Charitable Contribution for Non-itemizers (*section 3*)

Currently, an individual who claims the standard deduction is allowed a subtraction for charitable contributions. The subtraction is equal to 50% of the amount of contributions in excess of \$500.

The bill changes the allowed subtraction to 60% of the amount of contributions in excess of \$300, effective beginning with tax year 2020.

EXPLANATION OF THE BILL (Cont.)**K-12 Education Credit** (*sections 5 and 15*)

Under current law, a taxpayer is allowed a refundable income tax credit equal to 75% of eligible education expenses for a qualifying child in kindergarten through 12th grade. The maximum credit is \$1,000 for each child. Eligible expenses include fees for instruction outside the regular school day or school year, expenses for textbooks or instructional materials, and transportation costs paid to others. Tuition is not an eligible expense.

The maximum credit is phased out beginning at household income of \$33,500. For taxpayers with one child, the maximum credit is reduced by one dollar for every four dollars of household income over \$33,500. For taxpayers with two or more children, the maximum credit is reduced by two dollars for every four dollars of household income over \$33,500. The phase-out range is increased by \$2,000 for each additional child. The income thresholds are not indexed for inflation. Household income includes income from all sources, both taxable and nontaxable.

The bill would phase out the credit based on adjusted gross income over: 1) The current thresholds or 2) the income eligibility guidelines for the federal reduced school lunch program as of July 1 of the tax year, whichever is greater. The reduced lunch guidelines are equal to 185% of the federal poverty guidelines and vary with the size of the household. In determining the credit, a household would include the taxpayer (and spouse for married joint returns) plus any dependents, as defined in the Internal Revenue Code.

For taxpayers with one eligible child, the credit would be reduced by one dollar for every four dollars of adjusted gross income over the eligibility guideline. For taxpayers with two or more children, the maximum credit would be reduced by two dollars for every four dollars of adjusted gross income over the eligibility guidelines. The following table shows the eligibility guidelines for tax year 2020.

Proposed Phase-Out Thresholds

Tax Year 2020

Household Size	Annual Income
2	\$33,500
3	\$40,182
4	\$48,470
5	\$56,758
6	\$65,046
7	\$73,334
8	\$81,622

The thresholds are increased by \$8,288 for each additional household member. The 2020 reduced lunch guidelines are greater than the current K-12 credit phase-out threshold for all but two-member households. The thresholds are indexed annually for inflation.

EXPLANATION OF THE BILL (Cont.)**Combined Net Receipts Gradual Rates Reduction (section 6)**

The combined net receipts tax is imposed on a lawful gambling organization's net receipts after prizes from pull-tabs, tipboards, and electronic linked bingo. Tax rates are graduated from 9% to 36%. The tax does not apply to paper bingo, raffles, and paddlewheels, which are subject to a separate tax.

Combined Net Receipts Tax

Net Receipts			Rate
\$0	to	\$87,500	9%
\$87,501	to	\$122,500	18%
\$122,501	to	\$157,500	27%
\$157,501		or more	36%

Fiscal year gambling tax revenue in excess of \$36.9 million is either used for stadium-related expenses or added to the stadium reserve fund within the General Fund. In addition, one percent of total gambling revenues is appropriated to the Department of Human Services to address problem gambling.

Combined net receipts tax will change to the below graduated rates effective July 1, 2020. There is no change to the definition of net receipts nor adjustment to the types of games under this tax.

**Proposed
Combined Net Receipts Tax**

Net Receipts			Rate
\$0	to	\$87,500	8%
\$87,501	to	\$122,500	16%
\$122,501	to	\$157,500	24%
\$157,501		or more	32%

Extension for Filing and Payment (section 10)

The bill extends the filing and payment deadline for the 2019 tax year to July 15, 2020. The extension applies to individuals, partnerships, S corporations, or C corporations.

This section is effective the day following final enactment and applies retroactively to tax payments due and penalties and interest applied for the 2019 taxable year only.

Waive Penalties and Interest (section 12)

The bill waives any penalties and interest if a taxpayer had an increase in tax in 2018 due to gains on property that formerly qualified as like-kind exchange property. The waiver applies if a taxpayer had an increase of tax liability of at least 12% due to the retroactive adoption of the federal treatment of like-kind exchanges. This section is effective retroactively for interest and penalties on assessments ordered after June 1, 2019.

EXPLANATION OF THE BILL (Cont.)Delay Estimated Tax Payments (section 13)

For individual income tax filers, quarterly estimated payments are due on the 15th of April, June, September and the next January. For C corporations, quarterly payments are due on the 15th of the 3rd, 6th, 9th and 12th months of the tax year. Under the bill, for individuals, the April 15th, 2020 estimated payment may be submitted by July 15th, and the June 15th, 2020 estimated payment may be submitted with the September 15th payment. For C corporations, estimated payments due on May 15, 2020 may be included with the August 15, 2020 payment and estimated payments due on June 15, 2020 may be included with the September 15, 2020 payment. Penalties and interest do not apply to delayed payments as allowed under the bill.

The delay applies to individual income tax payments for tax year 2020 only and for corporate franchise tax payments for tax year 2019 and 2020 only.

Suspend June Accelerated Payments (section 14)

Taxpayers that are liable for the general sales and use tax that have a liability of \$250,000 or more during a fiscal year ending June 30, must pay 87.5% of the estimated June liability two business days before June 30.

The bill temporarily suspends the 2020 estimated payment of taxes for June 2020 with no penalty for taxes due and paid by July 20, 2020. This section is effective the day following final enactment and applies to payments of taxes collected in June 2020.

REVENUE ANALYSIS DETAILAngel Investment Credit (sections 1 and 15)

- It is assumed that the maximum credit of \$10 million per tax year would be allocated.
- Tax year impacts are allocated to the following fiscal year.
- Due to the repeal of the sunset, there would be an ongoing impact of \$10 million per year beyond the forecast window.

Section 179 Expensing (sections 2, 4 and 11)

- The estimates are based on estimates for the federal legislation prepared by the staff of the Joint Committee on Taxation, dated December 18, 2017.
- The estimate was divided between the individual income tax and corporate franchise tax based on the percentage of eligible property owned by entities subject to each tax.
- The estimate was apportioned to Minnesota and adjusted for differences in federal and state tax rates and federal and state fiscal years.
- All retroactive impacts and tax year 2020 impacts are allocated to FY 2021. Other tax years were allocated 30%/70% to fiscal years.

REVENUE ANALYSIS DETAIL (Cont.)Charitable Contribution for Non-itemizers (section 3)

- The House Income Tax Simulation Model (HITS 6.9) was used to estimate the revenue impact. These simulations assume the same economic conditions used by Minnesota Management and Budget for the forecast published in February 2020. The model uses a stratified random sample of tax year 2017 individual income tax returns compiled by the Minnesota Department of Revenue.
- The estimate was increased by 7.7% to account for newly eligible taxpayers claiming the subtraction, based on the percentage of itemizers with charitable contributions between \$300 and \$500 in tax year 2017.
- No adjustment was made to account for the above-the-line deduction for cash contributions in the federal CARES Act. It is assumed that a taxpayer could claim the federal deduction or the Minnesota subtraction, but not both for the same contributions. Conforming to that provision of the CARES Act would reduce the impact of the subtraction by about \$3.8 million in fiscal year 2021.
- Approximately 894,200 returns would benefit from the bill in tax year 2020. The average reduction in tax would be about \$30.
- Tax year impacts were allocated to the following fiscal year.

K-12 Education Credit (sections 5 and 15)

- The analysis is based on Minnesota income tax returns for tax year 2018. In that year, K-12 education credits totaled \$8.5 million on 34,600 returns.
- The estimate was adjusted for changes in income and education expenses since 2018.
- The proposed credit was estimated separately for: 1) those claimants that currently take the existing credit and 2) new taxpayers that can now claim the proposed credit.
- Any expenses used to claim the K-12 education credit reduce the amount that can be claimed as a subtraction. The estimate includes the tax benefit of the reduced education subtraction for those claimants that are better off with the proposed K-12 credit and no longer take the subtraction.
- For tax returns where there was no information on the number of qualifying children, the number of dependents aged 5-18 was used to estimate the number of qualifying children.
- A marginal rate of 5.7% is assumed.
- Consumer Price Index projections were applied to income and expenses for tax years after 2020.
- The estimate is increased by the estimated growth in population of children aged 5-18 from the Minnesota State Demographic Center.
- Tax year impacts are allocated to the following year.
- Approximately 51,800 returns would benefit from the proposed credit in tax year 2020, of which 17,100 would be newly eligible. The average credit would be \$421 compared to \$246 under current law.

REVENUE ANALYSIS DETAIL (Cont.)Combined Net Receipts Gradual Rates Reduction (section 6)

- The estimates are based on data from fiscal year 2019 gambling tax returns filed with the Department of Revenue.
- Over the four fiscal years, the bill will reduce gambling tax revenues, and amounts transferred for stadium purposes, by \$33.3 million.
- The bill reduces all rates proportionally by one-ninth. Total tax revenue is also reduced by about one-ninth.
- The estimate assumes all charitable gambling organizations will be able to resume business by July 1, 2020.
- There are appropriations to the Commissioner of Human Services of one-half of one percent of tax revenues for a compulsive gambling treatment program and one-half of one percent of tax revenues for a grant to increase public awareness of problem gambling and support for effective treatment services. The total appropriations for problem gambling of 1% would be reduced by \$333,000.
- There are about 1,100 charitable gambling organizations in Minnesota that pay the combined net receipts tax.

Extension for Filing and Payment (section 10)

- Final payments for individual income tax have already been delayed until July 15, 2020 by executive order. This estimate includes the marginal impact of delaying corporate franchise tax payments.
- Fiscal year filers with returns due in April, May, or June of 2020 are assumed to be affected by the filing extension. It is assumed that 5% of April final payments and 75% of May and June final payments will shift to fiscal year 2021.

Waive Penalties and Interest (sections 10, 12, and 13)

- The impact of waiving penalties and interest is unknown. Average monthly penalties and interest due in calendar year 2019 were about \$18.1 million. Of the total, \$10.5 million were penalties and \$7.5 million interest. The penalties and interest by tax area were: \$12.8 million income tax related sources, \$1.4 million corporate franchise tax, \$3.8 million sales and use tax, and less than \$0.1 million excise taxes.

Delay Estimated Tax Payments (section 13)

- Individual income tax estimated payments due on April 15th and June 15th would be delayed.
- Corporate franchise tax estimated payments due on May 15 and June 15th would be delayed.
- It is assumed that 5% of April payments and 75% of May and June final payments will shift to fiscal year 2021.

REVENUE ANALYSIS DETAIL (Cont.)

Suspend June Accelerated Payments (section 14)

- The estimates are based on accelerated payments received in June 2019.
- The June 2019 amounts were remitted at the prior requirement of 81.4% of June 2019 liability.
- The June 2019 amounts were increased annually by the gross receipts of affected taxes based on the February 2020 state revenue forecast.
- The June 2020 estimates were adjusted based on the current law requirement of 87.5%.
- The June accelerated payment suspension creates a shift in revenue collections from fiscal year 2020 to fiscal year 2021.

Minnesota Department of Revenue
Tax Research Division
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